

SAN FRANCISCO BAY CONSERVATION AND DEVELOPMENT COMMISSION

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March 5, 2004

TO: Commissioners and Alternates

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**SUBJECT: Staff Report and Recommendation on the Legislative Analyst's
Evaluation of the Governor's Proposed FY 04-05 Budget for BCDC
(For Commission consideration on March 18, 2004)**

Summary and Recommendations

The staff recommends that the Commission:

- (1) **OPPOSE** the recommendation of the Legislative Analyst's Office (LAO) that General Fund support for BCDC be reduced by \$1,954,000 below the level requested by the Governor in FY 04-05;
- (1) **OPPOSE** the LAO's recommendation that a special fund be established for the deposit of all BCDC fee revenues;
- (2) **SUPPORT WITH MODIFICATION** the LAO's recommendation that BCDC modify its permit fee schedule so that the Commission's regulatory program costs are fully recovered; and
- (3) **RECOMMEND** to the Governor and the Legislature that in FY 05-06 and each subsequent fiscal year, the revenue generated by the Commission, along with any needed additional appropriations from the General Fund, should be relied upon to support the Commission's regulatory operations.

Staff Report

Background: As part of its comprehensive analysis of Governor Schwarzenegger's proposed State budget for California's 2004-05 fiscal year, the Legislative Analyst's Office has included the following recommendation regarding BCDC's budget:

Recommend Revised Fee Structure, Creating General Fund Savings. *We recommend the enactment of legislation to direct the San Francisco Bay Conservation and Development Commission (BCDC) to modify its permit fee schedule so that its permitting and enforcement costs are fully recovered from fees and other non-General Fund sources (penalties and reimbursements). This would result in savings of close to \$2 million to the General Fund.*



San Francisco Bay Conservation and Development Commission

We further recommend the enactment of legislation to establish a special fund for the deposit of all of BCDC's fee revenues. (Reduce Item 3820-001-0001 by \$2,089,000 and increase new special fund item by a like amount.

The entire section of the Legislative Analyst's report explaining this recommendation is provided in Attachment A.

BCDC's Permit Fee Analysis. Last year, in response to direction from the Commission, the staff prepared a report that compared the cost of the Commission's permit operations with the revenue generated by permit fees, provided comparable fee schedules of other state and local government agencies, offered optional permit fee schedules and assessed how much additional General Fund revenue would be generated by each schedule (see Attachment B).

After considering the staff report at a public hearing on November 6, 2003, the Commission determined that it would be a sound public policy to incrementally increase BCDC's permit fees so that the full cost of BCDC's permit operations (including management, legal and administrative overhead) would eventually be recovered from permit applicants. The Commission also directed the staff to consult with members of the California Legislature from the Bay Area to gain their advise on four questions: (1) is there political support for the Commission's policy decision to raise its permit fees; (2) how long should BCDC take to phase in a full cost-recovery program; (3) should the fees for projects that provide substantial public benefits be waived; and (4) should legislation be enacted to ensure that the permit fees BCDC collects are dedicated to the support of the Commission's permit operations?

On December 3, 2003, the staff wrote to 22 members of the Legislature, as well as to the Secretary for Resources, the Director of Finance and the Legislative Analyst, to seek their advice on these issues. Possibly because of other pressing matters before them, there has very little response on these inquiries except from the Legislative Analyst's Office, which indicated it would be evaluating the permit fee issue as part of its budget evaluation. Therefore, the staff decided to await the release of the Legislative Analyst's report in mid-February before pursuing this matter further with members of the Legislature.

Legislative Analyst's Recommendation. In its recommendations, the Legislative Analyst goes beyond the policy conclusions of the Commission in four ways.

First, the LAO has recommended that the Commission's entire regulatory program, including enforcement as well as permitting, should be supported by fees and reimbursements. The Commission focused its analysis on its permit program because the enforcement program is already largely supported by revenue from the Bay Fill Clean-up and Abatement Fund into which civil penalties imposed by the Commission are deposited.

Second, the LAO has recommended that BCDC's permit fees should be increased immediately rather than incrementally over a period of time.

Third, the LAO has recommended that a new special fund should be established into which all BCDC's fee revenues be deposited.

Finally, the LAO has recommended that General Fund support for BCDC in FY 04-05 should be reduced by nearly \$2 million below the level requested by the Governor in the expectation that increased permit fees will be available to supplant the needed General Fund support for the Commission.

Each of these issues is discussed below.

1. Amount of Fee Level Increase. When the Commission reached its policy decision to eventually increase its permit fees to recover the total cost of BCDC's permit operations, the Commission used as its revenue target the \$1.9 million cost of the permit program in the current fiscal year. In contrast, the LAO has focused on the approximately \$2.6 million level of revenue needed to support BCDC's permitting and enforcement program. To generate the revenue

needed to eliminate the need for any General Fund support for BCDC's entire regulatory program, the Commission's permit fees would have to bring in almost \$2.1 million in FY 04-05—a level somewhat higher than that endorsed by the Commission last year. The following table compares the Commission's existing fee schedule, the fee schedule endorsed by the Commission in November, and the fee schedule needed to achieve the LAO's objectives.

PERMIT FEE SCHEDULE REVISIONS			
	Current Permit Fees	Fees Needed to Recover Permit Costs	Fees Needed to Recover All Regulatory Costs
The first time extension to a permit:	\$50	\$750	\$800
A nonmaterial amendment to a permit other than the first time extension:	\$100	\$1,500	\$1,600
An activity authorized under a regionwide permit:	\$100	\$1,500	\$1,600
A minor repair or improvement with a total project cost (TPC) of:			
• Less than \$300,000:	\$150	\$2,200	\$2,400
• \$300,000 to \$10,000,000:	.05% of TPC	.73% of TPC	.81% of TPC
• More than \$10,000,000:	\$5,000	\$73,000	\$81,000
Any other project that does not qualify as a minor repair or improvement with a total project cost (TPC) of:			
• Less than \$250,000:	\$250	\$3,700	\$4,000
• \$250,000 to \$10,000,000:	.1% of TPC	1.5% of TPC	1.62% of TPC
• More than \$10,000,000:	\$10,000	\$150,000	\$162,000
Estimated Annual Revenue Generated:	\$129,000	\$1,877,000	\$2,089,000

2. Timing of Fee Increase. Last year, the Commission endorsed an incremental approach for increasing its permit fees. An incremental fee increase approach would address three issues: (1) providing an opportunity to determine whether a new fee schedule would actually generate the targeted amount of revenue; (2) allowing time for permit applicants to accommodate increased fee levels into their project budgeting; and (3) dissipating political opposition to the increased fees. The immediate and large fee increase recommended by the LAO does not address any of these issues.

Moreover, even with dramatic increases in the level of its permit fees, there is no assurance that a new higher fee schedule would actually generate the revenue levels targeted by the LAO. As noted in the staff report considered by the Commission last year, under the current permit fee schedule the permit applications received during the present sluggish economic conditions in the Bay Area are expected to generate \$129,000 in revenue in FY 03-04. As the economy recovers, the number of permit applications and size of projects might increase, thus generating greater permit fee revenues. On the other hand, there is some possibility that a large and rapid increase in the permit fees charged by the Commission might dissuade some potential applicants from pursuing projects, which would reduce expected permit fee revenues.

The Commission's current permit fee schedule illustrates the difficulty in predicting the amount of revenue that will be generated. The current fee schedule, which has been unchanged since 1991, generated only \$69,000 in revenue in FY 01-02, but \$181,000 in FY 98-99. An identical statistical spread applied to a permit fee schedule designed to generate \$2.1 million in revenue shows that the actual annual revenues might be as little as \$1.2 million or as much as \$3.1 million.

If the Legislature accepts the LAO's recommendation to enact legislation to direct BCDC to modify its fee schedule, the legislation probably would not take effect until 2005 at the earliest. Even if legislation is passed as an urgency measure by two-thirds of the Legislature and signed by the Governor it is highly unlikely the public policy decisions recommended by the LAO could be rendered before the beginning of FY 04-05. Thereafter, revising the Commission's permit fee schedule can be accomplished only by amending the Commission's regulations. This is a complex process which normally cannot be accomplished in less than nine months, although special exceptions do allow regulations to be adopted on an expedited basis to deal with emergencies. Thus, even if the Commission immediately initiates the process of amending its fee schedule in advance of a decision by the Legislature and the Governor on the LAO's recommendation, it would probably be impossible for the Commission to revise its fee schedule in time to begin generating the higher level of revenues targeted by the LAO until well into the 2004-05 fiscal year. This would result in the Commission operating under deficits throughout FY 04-05 if General Fund support for its permit and enforcement program is eliminated at the beginning of the fiscal year as recommended by the LAO.

The staff believes it would be imprudent to initiate a revision in the Commission's permit fee schedule before the Administration and the Legislature have had an opportunity to evaluate this important public policy issue. In one of his first acts as Governor, Arnold Schwarzenegger issued an executive order suspending the approval of pending new regulations until May 2004. The underlying rationale for the Governor's executive order suspending the approval of new regulations was to give the Schwarzenegger administration an opportunity to evaluate the impact of existing regulations on the business climate in California. Undoubtedly, BCDC permit applicants will oppose significantly higher permit fees. If the Commission initiates a revision of its fee schedule, political opposition to the higher fees expressed to the Governor will likely delay the Office of Administration Law's approval of regulations needed to implement the new fee schedule. On the other hand, if after hearing the concerns of the regulated community, it is the will of the Governor and the Legislature that BCDC's fees need to be raised as part of an overall strategy for dealing with California's fiscal problems, the Commission can proceed with the revision of its regulations with some confidence that a new fee schedule will be approved in a timely manner.

3. Creating a New Special Fund. As with the fee schedule recommendation discussed previously, if the Legislature accepts the LAO's recommendation to establish a special fund for the deposit of BCDC's fee revenues, the legislation probably would not take effect before the beginning of FY 04-05. Therefore, for at least part of FY 04-05, BCDC's permit fees would have to continue to be deposited in the General Fund. If General Fund support for BCDC is reduced at the beginning of FY 04-05 as the LAO has recommended, absent an appropriation by the Legislature from the General Fund the Commission would have no access to the permit fees it deposits in the General Fund during the fiscal year; therefore, the Commission would end FY 04-05 in a deficit condition.

Creating a new fund would provide budgetary "transparency;" i.e., the revenue generated by the Commission's regulatory program would be earmarked to pay for the costs of the program. A new fund would also ensure that the Commission's permit fees deposited in the fund are reserved exclusively for the support of the Commission's regulatory operations.

Offsetting these accounting and budgetary advantages of a new fund are a number of significant disadvantages. First would be the obvious political tendency to use the balance in the

fund as the primary basis for determining the level of financial support needed to carry out the Commission's regulatory program even though from a budgetary standpoint the amount of permit fees collected one year cannot be used to predict the permit workload in the following year. For example, in the booming 1980s, BCDC processed an average of 252 applications per year for projects with an average cost of just over \$1 million. Permit fees averaged \$44,000 per year. In the early 1990s, during an economic downturn, the Commission received an average 226 applications per year for projects costing an average of only \$400,000. Average annual permit fees were \$129,000. In the late 1990s, even though the economy soared, the average permit workload increased to only 238 applications per year, but the average project cost jumped to \$2.8 million because several bridge seismic retrofit projects and the San Francisco Giants ball-park were included in the mix. Permit fees averaged \$98,000 per year. In the early 2000s, the economy faltered and applications dropped to average of 181 per year, but the average project cost soared to almost \$11 million fueled by two large Caltrans bridges, the Mission Bay project in San Francisco and the San Francisco cruise ship terminal. Average annual permit fees were \$126,000.

Thus, there are no clear correlations between economic conditions, permit workload, the value of projects, and permit fees collected. Nevertheless, in a political environment where the Commission's regulatory program is perceived to be self-supporting, this analytical fact will probably disappear.

Second, there is also considerable likelihood that creating a special fund would increase the cost to BCDC of its operations. Pro-rata costs are imposed on State agencies that utilize special funding sources to pay for the operation of other State agencies, including the Department of Finance, the Department of General Services and the Controller's Office. To pay these pro-rata costs, appropriations from the Bay Fill Clean-up and Abatement Fund have had to be increased by over ten percent. Similarly, the California Department of Justice absorbs the cost of providing legal services to General Fund-supported departments, but charges for its services when providing legal support to special fund departments. Therefore, if pro-rata charges of ten percent or more are imposed on the \$2 million in special fund support for BCDC recommended by the LAO, the Commission would either have to cut its operations by over ten percent or increase its permit fees to generate the \$200,000 or more needed to pay these charges.

Third, state fiscal management and accounting procedures are far more complex when dealing with revenues that are deposited into special funds. Therefore, collecting higher permit fees, depositing them in a special fund and monitoring the fund balances will increase the Commission's accounting workload.

Therefore, from BCDC's perspective there are a number of distinct advantages to continuing the practice of depositing the Commission's permit fees in the General Fund rather than creating a new special fund.

4. Reducing General Fund Support for BCDC. For the reasons explained above, if General Fund support for BCDC in FY 04-05 is reduced \$1,954,000 below the level requested by Governor Schwarzenegger, the Commission would begin the fiscal year with only about half of the revenue needed to support BCDC's operations and no assurance that additional revenues would be forthcoming during the fiscal year. California law prohibits State agencies from operating in a manner that will result in a deficit at the end of the fiscal year. Therefore, the reduction recommended by the Legislative Analyst will—intended or not—force the Commission to initiate the lay-off of at least half of BCDC's staff which would decimate the Commission's program and prevent BCDC from fulfilling State mandates.

Conclusion: A Refined Approach. As noted above, the recommendations of the Legislative Analyst are generally consistent with the policy conclusions of the Commission regarding BCDC's permit fees. However, the LAO recommendation fails to be realistic and workable in that it calls for too much, too fast. The staff believes the LAO's policy objectives, as well as those of the Commission, can be achieved by taking the following steps:

1. The Administration and the Legislature should determine whether they want BCDC to increase its permit fees to a level that will generate enough revenue to recover the costs of BCDC's entire regulatory program. If they do, the Administration should sponsor and the Legislature should enact legislation directing BCDC to modify its permit fee schedule so that the fees are incrementally increased over the next five years to a level that will fully recover BCDC's regulatory program costs from fees and other non-General Fund sources, as recommended by the LAO. (A multi-year fee schedule that would accomplish this goal is provided on page 7.)
2. The Administration and the Legislature should not implement the Legislative Analyst's recommendation that a new special fund be created into which BCDC's fee revenues would be deposited because there is little advantage to utilizing a new fund, and a number of distinct disadvantages.
3. The Administration and the Legislature should not implement the Legislative Analyst's recommendation that General Fund support for BCDC be reduced \$1,954,000 below the level requested by the Governor in FY 04-05. Instead, in FY 05-06 and each subsequent year, the Administration and the Legislature should first look to the revenue generated by the Commission and deposited in the General Fund when appropriating funds to support the Commission's regulatory operations. If the revenues generated by the Commission are insufficient, additional General Fund money should be appropriated to augment the fee revenues. If the revenues raised by the Commission exceed the amount needed in any fiscal year, the balance can be used for other purposes.
4. The Commission should closely monitor the amount of revenue raised by its permit fees and should modify its permit fee schedule as necessary to generate the targeted amount of revenue identified each year in a multi-year phased program designed to eventually recover the full cost of BCDC's regulatory operations.

The following table illustrates a multi-year fee schedule that can be expected to generate full-cost recovery of BCDC's regulatory program within five years.

MULTI-YEAR PERMIT FEE SCHEDULE					
	2005 Fees	2006 Fees	2007 Fees	2008 Fees	2009 Fees
The first time extension to a permit:	\$160	\$320	\$480	\$640	\$800
A nonmaterial amendment to a permit other than the first time extension:	\$320	\$640	\$960	\$1,280	\$1,600
An activity authorized under a regionwide permit:	\$320	\$64	\$960	\$1,280	\$1,600
A minor repair or improvement with a total project cost (TPC) of:					
• Less than \$300,000:	\$480	\$960	\$1,440	\$1,920	\$2,400
• \$300,000 to \$10,000,000:	.16%TPC	.32%TPC	.49%TPC	.65%TPC	.81%TPC
• More than \$10,000,000:	\$16,200	\$32,400	\$48,600	\$64,800	\$81,000
Any other project that does not qualify as a minor repair or improvement with a total project cost (TPC) of:					
• Less than \$250,000:	\$800	\$1,600	\$2,400	\$3,200	\$4,000
• \$250,000 to \$10,000,000:	.32%TPC	.65%TPC	.97%TPC	1.3%TPC	1.62%TPC
• More than \$10,000,000:	\$32,400	\$65,000	\$97,000	\$130,000	\$162,000
Estimated Annual Revenue Generated:	\$417,800	\$835,600	\$1,253,000	\$1,671,000	\$2,089,000